

**STATE OF CALIFORNIA
DEPARTMENT OF INSURANCE
300 Capitol Mall, Suite 1700
Sacramento, California 95814**

NOTICE OF PROPOSED ACTION

NOTICE DATE: June 5, 2009

REGULATION FILE: REG-2007-00054

SUBJECT OF PROPOSED RULEMAKING

Standards for Health History Questionnaires in Health Insurance Applications; Pre-Issuance Medical Underwriting Requirements; Rescission of Health Insurance Policies and Agent Attestation Requirements Regarding Assistance with Submission of Health Insurance Applications

The Insurance Commissioner proposes to adopt the regulations described below after considering comments from the public. The Commissioner proposes to add to Title 10, Chapter 5, Subchapter 2 of the California Code of Regulations the new Article 11: Standards for Health History Questionnaires in Health Insurance Applications, Pre-Issuance Medical Underwriting and Rescission of Health Insurance Policies, consisting of new Sections 2274.70, 2274.71, 2274.72, 2274.73, 2274.74, 2274.75, 2274.76, 2274.77, 2274.78 and 2274.79. The proposed regulations apply to all health insurance policies as defined in Section 106(b) of the Insurance Code. The regulations set forth standards for health insurers affecting the medical underwriting process that precedes the issuance of an individual health insurance policy, standards for the Commissioner's approval of questions which may be included on a health history questionnaire that is part of a health insurance application, attestation requirements for agents assisting applicants in submission of health insurance applications, standards for post-issuance rescission investigations conducted by health insurers and documentation requirements for business processes related to medical underwriting, claims handling, rescission investigations and related matters.

PUBLIC HEARING

The Commissioner will hold a public hearing to provide all interested persons an opportunity to present statements or arguments, either orally or in writing, with respect to this regulation, as follows:

Date and time: Monday, July 20, 2009 at 10:00 a.m.

**Location: Administrative Hearing Bureau Hearing Room
California Department of Insurance
45 Fremont Street, 22nd Floor
San Francisco, California 94105**

The hearing will continue on the date noted above until all testimony has been submitted or 4:00 p.m., whichever is earlier.

PRESENTATION OF WRITTEN COMMENTS; CONTACT PERSONS

All persons are invited to submit written comments on the proposed regulations during the public comment period. The public comment period will end at 5:00 p.m. on July 20, 2009. Please direct all written comments to the following contact person:

Andrea Rosen, Staff Counsel
California Department of Insurance
300 Capitol Mall, 17th Floor
Sacramento, CA 95814
Telephone: (916) 492-3508

Questions regarding procedure, comments, or the substance of the proposed action should be addressed to the above contact person. In the event the contact person is unavailable, inquiries regarding the proposed action may be directed to the following backup contact person:

Joel Laucher
California Department of Insurance
45 Fremont Street, 22nd Floor
San Francisco, CA 94105
Telephone: (415) 538-4381

DEADLINE FOR WRITTEN COMMENTS

All written materials must be received by the Insurance Commissioner, addressed to the contact persons at her address listed above, no later than 5:00 p.m. on July 20, 2009. Any written materials received after that time may not be considered.

COMMENTS TRANSMITTED BY E-MAIL OR FACSIMILE

The Commissioner will accept written comments transmitted by e-mail provided they are sent to the following e-mail address: rosena@insurance.ca.gov. The Commissioner will also accept written comments transmitted by facsimile provided they are directed to the attention of Andrea Rosen and sent to the following facsimile number: (916) 322-1925. **Comments sent to other e-mail addresses or other facsimile numbers will not be accepted. Comments sent by e-mail or facsimile are subject to the deadline set forth above for written comments.**

AUTHORITY AND REFERENCE

The proposed regulations will implement, interpret and make specific the provisions of Insurance Code sections 106, 380, 730, 734, 796.04, 10113, 10119.3, 10291.5, 10380, 10381.5 and 10384. Insurance Code sections 790.10, 10119.3, 10291.5, 10384, 12921 and 12926 provide authority

for this rulemaking, as do the following decisions of the California Supreme Court: *CalFarm Ins. Co. v. Deukmejian*, 48 Cal.3d 805 (1989), and *20th Century Ins. Co. v. Garamendi*, 8 Cal. 4th 216 (1994).

INFORMATIVE DIGEST

SUMMARY OF EXISTING LAW AND POLICY STATEMENT OVERVIEW

Existing law provides for regulation of health insurers, individual health insurance policies and agents who sell health insurance policies by the California Department of Insurance. Insurers offering individual health insurance policies for sale require an individual seeking health insurance coverage to complete and submit an application for individual health insurance coverage. Agents who are licensed by the Department of Insurance often assist applicants in a variety of ways in submission of their applications to the insurers who sell individual health insurance policies. As of January 1, 2009 Insurance Code Section 10119.3 requires agents who assist applicants in the submission of an application for health insurance coverage to make an agent attestation, stating and confirming their assistance to an applicant. The agent's attestation may be included on the written individual health insurance application submitted to the insurer for consideration or separately if the health insurance application is submitted electronically. The agent's attestation is intended to require the agent to state and confirm to the insurer whether the agent has assisted the applicant in submission of the health insurance application.

Existing law requires health insurers to submit the form they intend to use for an individual's application for health insurance, which includes a detailed health history questionnaire, to the Insurance Commissioner for review and approval. This review and approval occurs in conjunction with the Commissioner's review of proposed health insurance policy forms. Current law allows the Commissioner to reject a proposed individual health history questionnaire, which is considered part of the policy itself, if the questions are unintelligible, uncertain, ambiguous, abstruse or likely to mislead the applicant. Current law requires health history questions to be clear and unambiguous and limited to what is reasonably necessary for the insurer to conduct medical underwriting of the application. Current law requires any other writings related to the policy, such as an application for health insurance coverage, to be a part of the insurance policy which is the contract. Current law does not allow any other writings to be incorporated by reference; rather they must be attached to the policy to be considered part of the entire insurance contract. Existing insurance law requires that the completed individual health insurance application for coverage be attached to the policy when it is issued and delivered to the insured, if the insurer is to retain the right to rely on any statements made by the insured in the insured's individual health insurance application.

Insurance Code Section 10384 prohibits postclaims underwriting. Existing law prohibits rescission, cancellation or limitation of a health insurance policy that has been issued *unless* the insurer has fully accomplished both of the following tasks before the policy is issued: (1) completing medical underwriting and (2) resolving all reasonable questions

arising from written information submitted on or with an application. Rescission refers to the retroactive cancellation of an insurance policy back to the first day the policy was effective. Insurance Code Section 10384 establishes the timeline for an insurer to complete medical underwriting and resolve all reasonable questions arising from the written information such as the health history questionnaire submitted with the individual's application. Insurers must complete all of their medical underwriting of the individual's application for health insurance coverage *before* issuing a policy; insurers may not wait until *after* issuing the policy to complete medical underwriting of the insured.

Existing law does not allow an insurer to deny payment of claims under an insured's policy based on the insurer's assertion that the insured made a false statement in the application for coverage *unless* the insurer has attached a copy of the individual's original application for health insurance to the insurance policy at the time the policy is delivered to the insured.

Existing law prohibits certain enumerated acts that are considered unfair claims settlement practices. Medical claims cannot languish indefinitely while an insurer conducts a rescission investigation; they must be processed according to existing statutory and regulatory requirements applicable to claims handling. One goal of the proposed regulations is to require timely, reasonable and continuing notice to affected insureds and providers when an insurer commences a rescission investigation and claims payments are involved. Insureds are typically unaware that an insurer is conducting an investigation to determine whether to rescind an insured's coverage until claims for covered services are submitted and possibly denied for lack of coverage.

The California Insurance Commissioner has broad authority to conduct extensive examinations of an insurer's business including but not limited to all documents used in the transaction of such business, claims files, underwriting policies, procedures and forms, computer software programs used in any aspect of the insurer's business processes, vendors who supply information used by insurers and any external sources of information used to make underwriting decisions or inform the insurer who is evaluating a prospective risk of insuring an individual who has applied for health insurance coverage. Existing law imposes certain documentation requirements that allow for the Commissioner's examinations to be conducted in a manner necessary to determine compliance with existing insurance statutes and regulations including specific document retention requirements. The proposed regulations specify which kinds of documents related to the initial underwriting process, as well as to any rescission investigations an insurer might undertake, must be retained for the Commissioner's examination.

Existing laws allow for insurers to rescind, cancel or limit insurance policies issued to individuals but an insurers' right to rescind, cancel or limit an individual health insurance policy once issued is limited. Statutory and case law govern the standard under which such rescissions are evaluated by insurers before being executed. In *Thompson v. Occidental Life Insurance Company* (1973) 9 Cal.3d 904, the Supreme Court held that an applicant must have knowledge of the health history information sought and must

appreciate the significance of the information requested by the insurer. The burden of proof is on the insurer to demonstrate that the applicant had such knowledge, appreciated the significance of the health history questions and made material misrepresentations or omissions in their health history statements.

EFFECT OF PROPOSED ACTION

The proposed regulations clarify and make specific current insurance code statutes governing the Commissioner's evaluation of the clarity and simplicity of questions on a health history questionnaire intended to be used for medical underwriting by the insurer. The regulations will have the effect of prohibiting insurers from rescinding, cancelling or limiting an insurance contract unless they can meet the standards set for avoiding prohibited postclaims underwriting. The effect of these proposed regulations is to make unambiguous the type of conduct that constitutes complete medical underwriting and resolving all reasonable questions which arise from written information submitted on or with the application. The proposed regulations will have the effect of sharpening insurers' understanding of legal requirements regarding the business processes insurers must follow for completion of medical underwriting, as defined, before issuing a policy. However, if an insurer has not completed medical underwriting, as defined, prior to policy issuance, the regulations will prohibit the insurer from subsequently cancelling, rescinding or limiting the policy in question, unless it is shown that the applicant committed fraud when completing the application.

The proposed regulations define the conduct which constitutes prohibited postclaims underwriting and set detailed standards that insurers must meet before they can legally rescind an individual's health insurance coverage. The proposed regulations set forth standards for the use of external, objective sources of health information for use by insurers in the medical underwriting of a health insurance application for coverage. The proposed action encourages, but does not require, the use of a Personal Health Record — an innovative objective tool that can be very useful in the medical underwriting of an application by an insurer. The proposed action requires insurers to evaluate an individual's responses to health history questionnaire using a reasonable layperson standard in recognition of the intrinsically specialized, clinical nature of most health history questions in an individual health insurance application. The effect of the proposed regulations will be to encourage insurers to more tightly align their pre-issuance medical underwriting activities and decisions regarding information gathering to the specific requirements of their underwriting guidelines.

The proposed regulations specify the documents that must be maintained and retained for the Commissioner's market conduct examination of the wide range of business processes governed by these regulations.

The proposed regulations enumerate the circumstances under which an agent must provide an attestation regarding the agent's assistance in submitting an application. In recognition that the overwhelming majority of individual health insurance applications are submitted online via a web site, often one set up by health insurance agents, the

proposed action sets specific requirements for an agent's attestation in this circumstance. The effect of the proposed regulations is to establish notification and attestation requirements when an applicant submits an application for health insurance directly to the insurer via an agent's web site. The proposed regulation requires an agent to attest to the fact that the agent *did not* assist when an applicant submits an application directly to the insurer using the agent's web site and the agent has no contact whatsoever with the applicant prior to the issuance of the policy. The regulation enumerates the types of assistance an agent may provide which require the agent to attest to assisting an applicant. The proposed regulation has the effect of requiring an agent attestation of assistance after the applicant has been submitted but before the policy is issued if the applicant and agent have any communication whatsoever during this time period.

The proposed regulation imposes a time requirement on the insurer's return of a copy of the individual's health insurance application if the insurer issues an insurance policy in response to an individual applicant. The proposed regulation reinforces the existing requirement that the individual's application must be attached to the policy at the time of delivery to the insured. The proposed regulation states that if the individual's application is not attached to the policy at the time it is delivered, the application cannot be used by the insurer in any later attempt to rescind or cancel the policy.

The proposed regulations impose timeframe and notice requirements on an insurer's rescission investigation when medical claims have been submitted for payment under a health insurance policy. The proposed regulations eliminate any conceivable uncertainty as to the fact that existing laws governing claims handling continue to apply to all health care claims submitted under an insurance policy including any claims submitted during the time period of a rescission investigation. The proposed regulations require the insurer to notify the insured of the insured's right to have any rescission, cancellation or limitation of a policy by an insurer reviewed by the Department of Insurance regardless of whether the insured has filed an appeal with the insurer prior to seeking assistance from the Department.

MANDATES ON LOCAL AGENCIES OR SCHOOL DISTRICTS

The proposed regulations do not impose any mandate on local agencies or school districts. There are no costs to local agencies or school districts for which Part 7 (commencing with Section 17500) of Division 4 of the Government Code would require reimbursement.

COST OR SAVINGS TO STATE AGENCIES, LOCAL AGENCIES OR SCHOOL DISTRICTS OR IN FEDERAL FUNDING

The Commissioner has determined that the proposed regulations will result in no cost or savings to any state agency, no cost to any local agency or school district that is required to be reimbursed under Part 7 (commencing with Section 17500) of Division 4 of the Government Code, no other nondiscretionary cost or savings imposed on local agencies, and no cost or savings in federal funding to the State.

ECONOMIC IMPACT ON BUSINESS AND THE ABILITY OF CALIFORNIA BUSINESSES TO COMPETE

The Commissioner has made an initial determination that the adoption of the proposed regulations may have a significant, statewide adverse economic impact directly affecting business, including the ability of California businesses to compete with businesses in other states. The types of businesses that may be affected are health insurers and agents. The Commissioner has not considered proposed alternatives that would lessen any adverse economic impact on business and invites you to submit proposals. Submissions may include the following considerations:

- (i) The establishment of differing compliance or reporting requirements or timetables that take into account the resources available to businesses.
- (ii) Consolidation or simplification of compliance and reporting requirements for businesses.
- (iii) The use of performance standards rather than prescriptive standards.
- (iv) Exemption or partial exemption from the regulatory requirements for businesses.

POTENTIAL COST IMPACT ON PRIVATE PERSONS OR BUSINESSES

The Commissioner expects that health insurers could incur additional costs by adopting more robust pre-issuance underwriting practices as a result of the proposed action. Purchasing medical and pharmacy information from commercial vendors who own such databases could cost several million dollars. These data would supplement information provided by the individual applicant and assist the insurer in completing medical underwriting. Health insurers will incur costs related to improving and updating the health history questionnaires used to complete medical underwriting to comply with the proposed regulations but these costs are expected to be relatively minor. Once the new forms approved by the Department, the updated forms will improve the insurer's ability to complete medical underwriting in a more efficient manner.

If any insurers currently engage in the business practices that might be characterized as prohibited postclaims underwriting such as failing to complete medical underwriting prior to issuing a health insurance policy or related conduct, including failing to attach the health insurance application to an insured's policy upon delivery, failing to secure the agent's attestation as to assisting an applicant in submitting a health insurance application to an insurer or attempting to ask unclear and ambiguous health history questions in the individual health insurance application, such insurers will incur substantial additional costs to attain compliance with the proposed regulations. The additional cost of (1) obtaining an applicant's medical records, when necessary, and a Personal Health Record, if available, and (2) requesting statements from an applicant's Attending Physician(s), could be on the order of millions of dollars for insurers who currently conduct minimal pre-issuance medical underwriting. Certain underwriting expenses, such as obtaining medical records for applicants, are scalable depending on the number of applications received and depending on whether or not an insurer currently obtains and utilizes commercially available medical and/or pharmacy databases. Smaller insurance companies will incur lower absolute costs compared to larger companies that receive several thousand applications each month.

Based on the Commissioner's recent market conduct examinations and enforcement of statutes that are referenced in the proposed action and the subsequent settlement of rescission-related enforcement actions, the Commissioner reasonably expects most of the State's insurers to become compliant with the proposed action without incurring inordinate costs as a result of the proposed action. This conclusion is based on representations that the State's large insurers have made to the Commissioner in the course of recent market conduct examinations and during recent settlement discussions. Based on Market Conduct examinations of health insurers and recent large settlement actions with certain health insurers who agreed to submit corrective action plans to the Department, the Commissioner has determined that most of the requirements of the proposed action have already been incorporated into the largest health insurers' cost of selling individual health insurance. However, the approximately 15% of the health insurance industry that has not been the subject of an enforcement action may not yet be conducting medical underwriting as defined by the proposed action. These insurers may incur significant costs in securing access to commercial databases if needed to complete medical underwriting. The Commissioner is aware that certain health insurance companies have simply decided not to rescind individual health insurance contracts in order to avoid the possibility of engaging in prohibited postclaims underwriting. For these companies, the cost of complying with the proposed action will be quite low.

The technology and information databases that may be used in conjunction with medical underwriting of individual health insurance applications continue to rapidly evolve in the marketplace. As new software is developed to mine claims data, health insurance companies desirous of sharpening their prospective determination and acceptance of certain proposed health insurance risks through more rigorous use of data derived from large claims databases, including their own claims databases, will incur costs to obtain and deploy this data. Since much of this technology has not yet been developed, the costs are impossible to predict at this time. The entire area of Health Information Technology (HIT) is growing rapidly and is expected to receive large capital infusions from the recently enacted federal stimulus legislation. Improved HIT will facilitate the mining of claims data which can result in improved data for medical underwriting. However, these costs would likely be incurred in the absence of the Commissioner's proposed action as they are the current costs of remaining competitive in the individual health insurance market in California as companies are forced to do a better job of risk selection. These costs would likely be necessary if an insurer wished to retain its ability to rescind individual health insurance policies and minimize the risk of costly private litigation, absent the proposed regulations. Furthermore, the cost of conducting complicated and legally risky rescissions of individual's health insurance continues to rise in California with the increase in protracted legal class actions brought on behalf of those whose health insurance has been rescinded. Costs associated with compliance with the proposed regulations may be somewhat mitigated by the avoided costs of future legal actions brought by private parties whose health insurance coverage has been rescinded.

EFFECT ON JOBS AND BUSINESSES IN CALIFORNIA

The Commissioner is required to assess any impact the regulations may have on the creation or elimination of jobs in the State of California, the creation of new businesses, the elimination of existing businesses, and the expansion of businesses currently operating in the state.

The proposed action could increase the time an insurer spends underwriting an application for individual health insurance. A longer process for processing such applications may delay the sale of health insurance for those individuals who meet the insurer's underwriting requirements and are able to pay the final premium required to buy the coverage. The proposed action is not expected to eliminate any jobs or existing businesses in California. The proposed action may provide additional opportunities for expansion of information technology businesses who supply information used for medical underwriting of individual health insurance applications and for underwriters and actuaries who will be needed in the event an insurer increases its pre-issuance medical underwriting activities to achieve compliance with the proposed regulations. However, the number of jobs or new businesses, if any, that will be created, as well as the degree to which businesses currently doing business in the state may expand, as a result of the proposed regulations is presently unknown.

FINDING OF NECESSITY

The Commissioner finds that it is necessary for the welfare of the people of the state that the regulations apply to businesses.

IMPACT ON HOUSING COSTS

The proposed regulations will have no significant effect on housing costs.

ALTERNATIVES

The Commissioner must determine that no reasonable alternative considered by the Commissioner or that has otherwise been identified and brought to the attention of the Commissioner would be more effective in carrying out the purpose for which this action is proposed or would be as effective and less burdensome to affected private persons than the proposed action.

IMPACT ON SMALL BUSINESS

The Commissioner has determined that the proposed amendments will affect small businesses to the extent that it affects insurance agents. However, insurance companies, which will also be affected, are by definition not small businesses, pursuant to Paragraph (b)2) of Government Code section 11342.610.

COMPARABLE FEDERAL LAW

There is no comparable federal law as these matters are entirely within the purview of the state insurance law with no overlapping federal law or pre-emption by federal law.

TEXT OF REGULATIONS AND STATEMENTS OF REASONS

The Department has prepared an initial statement of reasons that sets forth the reasons for the proposed action. Upon request, the initial statement of reasons will be made available for inspection and copying. Requests for the initial statement of reasons or questions regarding this proceeding should be directed to the contact person listed above. Upon request, the final statement of reasons will be made available for inspection and copying once it has been prepared. Requests for the final statement of reasons should be directed to the contact person listed above.

The file for this proceeding, which includes a copy of the express terms of the proposed regulations, the statement of reasons, the information upon which the proposed action is based, and any supplemental information, including any reports, documentation and other materials related to the proposed action that is contained in the rulemaking file, is available by appointment for inspection and copying at 300 Capitol Mall 17th Floor, Sacramento, California 95814, between the hours of 9:00 a.m. and 4:30 p.m., Monday through Friday.

AUTOMATIC MAILING

A copy of this notice, including the informative digest, which contains the general substance of the proposed regulations, will automatically be sent to all persons on the Insurance Commissioner's mailing list who have indicated an interest in health insurance related matters.

WEBSITE POSTINGS

Documents concerning this proceeding are available on the Department's website. To access them, go to <http://www.insurance.ca.gov>. Find at the righthand side of the page the heading 'QUICK LINKS.' The third item in this column under this heading is 'For Insurers'; on the drop-down menu for this item, select 'Legal Information.' When the 'INSURERS: LEGAL INFORMATION' screen appears, click the third item in the list of bulleted items near the top of the page: 'Proposed Regulations.' The 'INSURERS: PROPOSED REGULATIONS' screen will be displayed. Select the only available link: 'Search for Proposed Regulations.' Then, when the 'PROPOSED REGULATIONS ' screen appears, you may choose to find the documents either by conducting a search or by browsing for them by name.

To browse, click on the 'Currently Proposed Regulations' link. A list of the names of regulations for which documents are posted will appear. Find in the list the "Postclaims Underwriting Regulations (PCUW)" link, and click it. Links to the documents associated with these regulations will then be displayed.

To search, enter "REG-2007-00054" (the Department's regulation file number for these regulations) in the search field. Alternatively, search by keyword ("rescission" for example, or "health history"). Then, click on the 'Submit' button to display links to the various filing documents.

MODIFIED LANGUAGE

If the regulations adopted by the Department differ from those which have originally been made available but are sufficiently related to the action proposed, they will be available to the public for at least 15 days prior to the date of adoption. Interested persons should request a copy of these regulations prior to adoption from the contact person listed above.